

[Issued in February 2025]

Background

CARE Ratings Limited (CARE Ratings) assigns ratings on a short-term rating scale for instruments and facilities with original maturity of up to one year. The short-term ratings are usually mapped to the long-term ratings in conjunction with an evaluation of the liquidity profile of the entity being rated, which entails an analysis of the working capital management, variations in the working capital cycle and adequacy of internal accruals for meeting the short-term financial obligations. The long-term fundamental credit quality assessment by CARE Ratings essentially includes analysing the operational and financial risk profile of the entity being rated. Besides the quantitative factors, qualitative aspects like assessment of management capabilities play a very important role in arriving at the rating of an instrument. The relative importance of the qualitative and quantitative components of the analysis varies with the type of the entity. Rating determination is a matter of experienced and holistic judgment, based on the relevant quantitative and qualitative factors impacting the credit quality of the entity.

Rating criteria for short-term instruments

CARE Ratings' approach for rating a short-term debt instrument is similar to the one followed for assessing the credit risk associated with the long-term instruments. Though the time horizon of a short-term instrument is up to one year, the time horizon for arriving at the rating normally extends beyond this period, since the attempt is to arrive at the rating which does not change frequently.

Assessing liquidity and financial flexibility of an entity gains more prominence while arriving at the short-term rating apart from its basic fundamental credit analysis.

- **Liquidity:**

Analysing liquidity is crucial for arriving at the short-term rating. This involves analysing the cash flows, working capital management, and examining the availability of any unencumbered liquid investments or unutilised committed lines of credit from the lenders for repaying the debt maturing in the short term. The assumptions underlying the cash flow projections are analysed to make a realistic assessment of the short-term liquidity. Similarly, examination of the asset-liability maturity (ALM) profile across various maturity buckets becomes important for assessing the liquidity position of the entities in the financial sector. Within the financial sector entities, the banks usually command a superior liquidity profile which is attributable to better access to capital and money markets, including financing options from the Reserve Bank of India (RBI), such as repo and liquidity adjustment facility. Please refer to CARE Ratings' criteria on 'Liquidity Analysis of Non-Financial Sector Entities' as well as the section on Liquidity Ratios under the criteria on 'Financial Ratios – Non-Financial Sector' / 'Financial Ratios – Financial Sector' / 'Financial Ratios - Insurance Sector' on CARE Ratings' website www.careratings.com for more insights on this aspect.

- **Financial flexibility:**

Financial flexibility refers to the alternative sources of liquidity available to an entity as and when required. While low level of leverage provides flexibility to an entity to raise additional borrowings, alternative sources of liquidity can be:

- a) General line of credit from a strong parent or group company.

- b) Strong group credit profile which could implicitly mean the possibility of a group support in the times of stress. It may be noted that high levels of pledged shareholding of the promoters could, however, affect an entity's financial flexibility, and may even affect its own liquidity position and ability to raise fresh funds.
- c) Back-up lines of credit from the lenders, etc. Short-term debt issued in the form of commercial paper (CP) is often carved out of the working capital limits of an entity thus, implicitly creating back-up liquidity. Though this type of arrangement reduces the chances of default in repayment of CP, it does not fully eliminate it. Inability or unwillingness of the lender to restore the limits or shortfall in the drawing power could lead to inadequacy of back-up liquidity at the time of CP maturity. Hence, the extent of utilisation of the working capital facilities and likely variation in the drawing power are studied in detail to in order to assess the nature of cushion available for the repayment of CPs.
- d) Implementing large projects usually involves periods of strain on an entity's liquidity position. CARE Ratings analyses factors like financial closure, stage of the project, drawdown schedule of the funds and various milestones of implementation of the capital expenditure programme. In this context, flexibility to defer the capital expenditure or implement the project in phases eases the strain on the liquidity of an entity and thus, provides comfort in terms of financial flexibility.

Short-term – Long-term mapping framework

Even though the short-term factors may tend to skew the short-term rating, the long-term credit quality assumes a pervasive role in determining the short-term rating. An entity with favourable long-term fundamentals will find it much easier to fulfil its short-term commitments on account of its strong operating cash flows and its ability to leverage upon its strengths to refinance the debt, if required. This implicitly establishes a link between the long-term and the short-term rating. Moreover, many of the short-term instruments tend to get 'rolled over', and though short-term by design, they virtually behave like long-term instruments. In the eventuality of an entity facing difficulties to roll-over the short-term instrument, it may have to leverage its long-term rating to refinance / get the funds in the absence of any other short-term funding sources. Thus, an entity's long-term credit quality cannot be ignored while assigning short-term rating.

Although the short-term rating is correlated to the long-term rating, the assessment of an entity's liquidity provides some flexibility in determining the mapping of a given long-term rating into the short-term scale. Essentially, the long-term rating has a wider scale, while the short-term rating scale is much shorter due to which there may not be a one-to-one mapping between the two scales. Moreover, the mapping considered for the financial sector entities may be different from that for the entities in the non-financial sectors, primarily due to better liquidity and easier access to the funds by the former. CARE Ratings may differ from its general mapping framework (refer to table below) if it has reasons to attribute a superior or an inferior short-term credit quality and accordingly, assign a higher or lower short-term rating based on an evaluation of the present and the envisaged liquidity position of the entities.

CARE Ratings' indicative mapping of short-term ratings to long-term ratings

Long-term ratings [^]	Corresponding short-term ratings [^] mapping (indicative)								
	A1+	A1	A2+	A2	A3+	A3	A4+	A4	D
AAA	Teal								
AA+	Teal								
AA	Teal								
AA-	Teal								
A+	Teal	Teal							
A	Grey	Teal	Teal						
A-		Grey	Teal	Teal					
BBB+			Grey	Teal	Teal				
BBB				Grey	Teal	Teal			
BBB-					Grey	Teal			
BB+							Teal	Teal	
BB							Teal	Teal	
BB-							Grey	Teal	
B+								Teal	
B								Teal	
B-								Teal	
C									Teal
D									Teal

[^]'CARE' prefix to be used with the rating symbols.

Note: Indicative mapping with 'teal colour' background in the above table reflects the mapping generally used by CARE Ratings, while indicative mapping in 'grey colour' background shows certain situations arising from superior liquidity-related aspects for the entity.

[For the previous version, please refer to 'CARE Ratings' Criteria for Rating of Short Term Instruments' issued in [February 2023](#)]

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About:

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